No. 79-477

In the Supreme Court of the United States

OCTOBER TERM, 1979

FIRST STATE BANK OF HUDSON COUNTY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

WADE H. MCCREE, JR.
Solicitor General

ALICE DANIEL
Assistant Attorney General

RONALD R. GLANCZ
HARLAND F. LEATHERS
Attorneys
Department of Justice
Washington, D.C. 20530

In the Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-477

FIRST STATE BANK OF HUDSON COUNTY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 23a-35a) is reported at 599 F.2d 558. The opinion of the district court (Pet. App. 17a-22a) is reported at 471 F.Supp. 33.

JURISDICTION

The judgment of the court of appeals (Pet. App. 36a) was entered on May 30, 1979. A petition for rehearing was denied on June 22, 1979 (Pet. App.

37a). The petition for a writ of certiorari was filed on September 20, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the United States is liable to a bank under the Federal Tort Claims Act for an alleged failure to notify the directors of the bank of improprieties discovered during an examination by the Federal Deposit Insurance Corporation.

STATEMENT

Petitioner, a New Jersey state-chartered bank, commenced operation in Jersey City, New Jersey, in 1969, and Edward P. Dooley became president in September 1970. Petitioner's deposits were federally insured under the Federal Deposit Insurance Act, 12 U.S.C. 1811 *et seq.* In the fall of 1971, petitioner applied for approval of a new branch office, which occasioned a routine investigation by the Federal Deposit Insurance Corporation that began in February 1972. On June 1, 1972, the FDIC sent a report to petitioner that criticized its management and loan policies (Pet. App. 24a).

Petitioner responded to the report by letter of June 20, 1972, that declared that it was taking steps to correct the problems. This letter was signed by the secretary of the board of directors. Petitioner now alleges in its complaint that this letter was actually prepared by Dooley and that it "contained willfully

false information and deliberately concealed material facts known at the time only to Dooley" (Pet. App. 25a; see also Pet. 5).

The FDIC allegedly undertook a further inquiry, without petitioner's knowledge, on July 11, 1972, with a second inquiry on September 11 and 12, 1972 (Pet. App. 25a). During the course of these inquiries, the FDIC allegedly learned that Dooley had been making false statements to the FDIC. Petitioner was not informed of these discoveries. On October 20, 1972, petitioner sent a second letter to the FDIC again stating that it was reforming its practices, but which petitioner now asserts contained willfully false information and deliberately concealed material facts (*ibid.*). On October 26, 1972, the FDIC acknowledged the letter of October 20 and requested additional information. Petitioner responded on October 30, 1972, with a further letter that also contained willfully false and misleading statements (*ibid.*). On July 19, 1973, Dooley was summarily dismissed as president by the board of directors.

Petitioner alleges that it first learned in February 1976 that the FDIC had discovered improprieties in July 1972 and had not reported them to the board of directors. After seeking administrative relief, petitioner commenced this action in the United States District Court for the District of New Jersey, claiming damages under the Federal Tort Claims Act (FTCA), 28 U.S.C. 1346(b), 2671-2680, for losses caused by Dooley's mismanagement between July 11, 1972 and July 19, 1973. The complaint alleged that the FDIC had breached a duty owed to petitioner

by failing to notify the board of directors of Dooley's improprieties (Pet. App. 26a).

The district court dismissed the complaint on three separate grounds:[1] (1) the FDIC did not owe any duty to petitioner (Pet. App. 19a); (2) petitioner's claim is barred by two exclusions under the FTCA (28 U.S.C. 2680(a) and (h)), because if there were a duty to notify, its breach would amount to a claim of implied misrepresentation, and any failures of the FDIC to take action were discretionary decisions (Pet. App. 19a-20a); and (3) the administrative claim, a precondition to suit under the FTCA, was not filed within two years of the alleged tort, as required by 28 U.S.C. 2401(a) (Pet. App. 20a-21a).

The court of appeals affirmed on the ground that the FDIC did not owe a duty to petitioner, stating (Pet. App. 28a):

> The Bank suggests three possible sources of a duty owed to it by the FDIC * * *. After carefully reviewing the Bank's contentions as to the duty owed to it, we conclude that no duty arose from these sources, either separately or together.

Accordingly, the court of appeals did not consider the other two grounds on which the district court's holding was based (*id.* at 35a).

---

[1] The court of appeals treated this dismissal as a grant of summary judgment under Fed. R. Civ. P. 56 because the district court considered certain evidence outside the pleadings (Pet. App. 27a).

ARGUMENT

Petitioner contends (Pet. 8-17) that the United States is liable under the Federal Tort Claims Act for the losses caused by Dooley's mismanagement because the FDIC breached a duty owed to petitioner in failing to notify the board of directors of the improprieties allegedly discovered during its inquiries in July and September 1972. This contention is without merit.

No provision of New Jersey state law (see Pet. App. 33a) or of the Federal Deposit Insurance Act, 12 U.S.C. 1811 *et seq.*, establishes a duty on the part of the FDIC to warn banks of improper activities of their own officials. As the court of appeals found (Pet. App. 29a-30a), the purpose of the bank examinations authorized by 12 U.S.C. 1820(b) is to prevent losses that would result in claims against the FDIC insurance fund, not to "ring the alarm bell to arouse drowsy directors" (Pet. App. 30a). In *Harmsen* v. *Smith*, 586 F.2d 156, 157 (1978), an FTCA action based on the alleged negligence of the Comptroller of the Currency in performing a bank examination under the National Bank Act, the Ninth Circuit stated:

> Although bank examinations may reveal irregularities and even fraud, which discoveries may redound to the benefit of innocent persons, including stockholders, that result is merely an incidental benefit to the examined banks. We agree with every other court that has considered

> the issue that the federal scheme of bank regulation creates no duty from the Comptroller to shareholders and directors of national banks.

Every court that has considered the question is in agreement with the conclusion that the FDIC owes no duty to a bank to warn it of improprieties in management that the FDIC discovers in the course of its examinations. See *Emch* v. *United States*, 474 F. Supp. 99 (E.D. Wis. 1979); *In re Franklin National Bank Securities Litigation*, 445 F. Supp. 723, 730-733 (E.D. N.Y. 1978); *Social Security Administration Baltimore Federal Credit Union* v. *United States*, 138 F. Supp. 639, 646 (D. Md. 1956). See also *Redmond* v. *United States*, 518 F.2d 811 (7th Cir. 1975) (SEC regulation does not create any duty to warn).[2] Hence, the court of appeals was correct in ruling that (Pet. App. 31a):

> the Federal Deposit Insurance Act imposes no duty on the FDIC to warn the officers and directors of a bank about wrongdoing committed by one of its officials and discovered by the FDIC. The duty to discover fraud in their institutions is upon bank directors and they may not transfer it to the FDIC by the easy expedient of purchasing insurance protection from it.

[2] Petitioner contends (Pet. 12-14), however, that a duty to warn arose under the FDIC's *Manual of Examination Policy*. The section of the *Manual* that establishes reporting procedures states that "[g]enerally and where feasible, upon discovery of an apparent violation the Examiner should report it to the Bank's Board of Directors" (Pet. App. 31a). The court of appeals correctly held that an internal operating manual cannot grant to a bank rights that do not exist under the statutory framework (*id.* at 32a). Moreover, the procedures in the *Manual* are not mandated by statute or regulation, but were devised and are followed pursuant to an exercise of the FDIC's discretion. Thus, any tort suit based on these procedures is barred by the discretionary function exception to the FTCA, 28 U.S.C. 2680(a).

Finally, even if the FDIC did breach a duty to petitioner in failing to notify it of facts uncovered in an examination, the claim would not be cognizable under the FTCA. An action based on a failure to inform a party of problems discovered does not establish any tort other than one of an implied misrepresentation that no problems exist. See, *e.g.*, *United States* v. *Preston*, 596 F.2d 232 (7th Cir. 1979), cert. denied, No. 79-68 (Oct. 15, 1979). An action for misrepresentation is explicitly excluded from the FTCA. 28 U.S.C. 2680(h); *United States* v. *Neustadt*, 366 U.S. 696 (1961).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

ALICE DANIEL
Assistant Attorney General

RONALD R. GLANCZ
HARLAND F. LEATHERS
Attorneys

DECEMBER 1979

☆ U. S. GOVERNMENT PRINTING OFFICE: 1979 306355 153